STATE OF SOUTH AUSTRALIA & ANOR.

v.

THE COMMONWEALTH OF AUSTRALIA & ANOR.

HIGH COURT, AUSTRALIA
MASON CJ
BRENNAN J
DEANE J
DAWSON J
TOOHEY J
GAUDRON J
MC HUGH J
[F.C. 92/004]
25 FEBRUARY 1992

STATUTORY INTERPRETATION: *Whether prior to 19 October 1989 was SASFIT, and is SASFIT now the State of South Australia within the meaning of s. 114 of the Constitution - "Property of any kind belonging to a state" within the meaning of s. 114 of the Constitution.*

REVENUE LAW: *Whether SASFIT is exempt from paying income tax on income received into or on account of the Fund or net capital gains made by the Fund - By reason of s. 114 of the Constitution and s. 271 of the Income Tax Assessment Act 1936 (Cth) - Whether the same applies after 19 October 1989.*

The plaintiffs, the State of South Australia and the South Australian Superannuation Fund Investment Trust ("SASFIT") commenced an action in this Court seeking declarations (a) that SASFIT is "a State" for the purposes of s. 114 of the constitution (b) that the plaintiffs are not liable to pay income tax on income received into or on account of the South Australian Superannuation Fund ("the Fund") or on net capital gains made by the Fund for the period from 1 July 1988 to 19 October 1989 by reason of s. 114 of the constitution and s. 271 of the Income Tax Assessment Act 1936 (Cth) ("the Act") and (c) that the plaintiffs are not liable to pay income tax in respect of income received into or on account of the Fund and not capital gains made by the Fund after 19 October 1989.

The defendants the Commonwealth of Australia and the Commissioner of Taxation, assert that SASFIT is not the State Of South Australia, that the Fund is not property of the state and that the relevant laws, the Taxation Laws Amendment Act (No. 2) 1989 (Cth) and the Taxation Laws Amendment (Superannuation) Act 1989 (Ch.) do not operate so as to impose a property of any kind belonging to the State of South Australia.

Pursuant to s. 18 of the Judiciary Act 1903 (Cth) the learned Chief Justice stated a case for the consideration of the Full Court. The following questions were reserved for the opinion of the Full Court:

1. (a) Prior to 19 October 1989 was SASFIT; and

   (b) is SASFIT now

The State of South Australia within the meaning of s. 114 of the Constitution?

2. (a) Prior to 19 October 1989 was property held on account of the Fund; and

   (b) is property now held on account of the Fund.

"Property of any kind belonging to a state" within the meaning of s. 114 of the Constitution?

3. Is SASFIT exempt from paying income tax on income received into or on account of the Fund or net capital gains made by the fund for the period 1 July 1988 to 19 October 1989 by reason of s. 114 of the Constitution and s. 271 of the Act?

4. Is SASFIT exempt from paying income tax on income received into or on account of the Fund or net capital gains made by the Fund after 19 October 1989 by reason of s. 114 of the Constitution and s. 271 of the Act?

Held:

[1] In the evolution of the interpretation of s. 114 it came to be recognised that a distinction should be drawn between a tax on property and a tax on transactions, a distinction which was applied where customs duty levied on the importation by a state of steel rails was held to be a customs duty on the movement of goods rather than a tax on property. Although the distinction between a tax on property and a tax on transaction has continued to be a very important factor in the interpretation and application of the section, it has been acknowledged that a tax framed as a tax on transaction may nevertheless in some circumstances amount to ownership or holding of property.

[2] That is because the prohibition contained in s. 114 is a matter of substance rather than of form and because a tax imposed by references to the ownership or holding of property may take the form of a tax on transaction.

[3] Viewed in the light of these general considerations, the income tax (excluding capital gains tax) imposed by the Act on income produced by property belonging to the taxpayer cannot be characterised generally as a tax on the ownership or holding of that property, income tax generally cannot be characterised as a tax of that kind. However, it is conceivable that the particular relationship between a type of income and the property which produces it might be such that the income tax imposed by the tax on taxable income calculated by reference to that type of income is, for relevant purposes, a tax on the property.

[4] True it is that the capital gains tax is not levied on the proceeds of sale of an asset. But the net capital gains which represent part of the proceedings sale fall into assessable income. And the reason for the imposition of the tax is the exercise by the taxpayer of the right of disposition, a right central to the concept of ownership of property. Futhermore, the capital gains tax imposed by the Act namely, the amount of the capital gain is computed by reference to the length of time during which the taxpayer has been the owner of the asset. Viewed in this light, the tax is a tax on the ownership or holding of property belonging to the taxpayer.

[5] The scope of the s. 114 immunity thus extends to taxation on property of any kind, whether the property be an item of revenue or an item of capital. Indeed, if s. 114 were not to protect the revenue of a state from taxation by the Commonwealth and the revenue of the Commonwealth from taxation by a state, the taxing power if either polity could be undermined by an exercise of the taxing power of the other. The immunity would be illusary if tax revenue could be depleted by adverse taxation. And s. 114 would have an illogical operation if it failed to protect the revenue of a state or the revenue of the commonwealth from taxation by the other but protected capital held or owned by a state or by the Commonwealth.

[Order in terms.]

Cases referred to:

Re Exported Natural Gas Tax [1982] 1 SCR 1004 ***(cons)***

D'Emden v. Peddler [1904] 1 CLR 91 ***(cons)***

A.G. of N.S.W v. Collector of Customs for N.S.W [1908] 5 CLR 818 ***(cons)***

The Municipal Council of Sydney v. The Commonwealth [1904] 1 CLR 208 ***(cons)***
Queensland v. The Commonwealth (The First Fringe Benefits Tax case) [1987] CLR 74 ***(foll)***
Superannuation Fund Investment Trust v. Commissioner of Stamps [1980] 25 SASR 35 ***(cons)***
Bennett & White (Calgary) Ltd. v. Municipal District of Sugar City No. 5 [1951] AC 786 ***(cons)***
Merchants' Loan & Trust v. Smietanka [1921] 255 US 509 ***(cons)***
United States v. Stewart [1940] 311 US 60 ***(cons)***
New Zealand Flax Investment Ltd v. Federal Commissioner of Taxation [1938] 61 CLR 179 ***(cons)***
Harding v. Federal Commissioner of Taxation [1917] 23 CLR 119 ***(dist)***
Federal Commissioner of Taxation v. Thorogood [1927] 40 CLR 454 ***(foll)***
Arthur Murray (N.S.W) Pty. Ltd. v. Federal Commissioner of Taxation [1965] 114 CLR 314 ***(foll)***
Norman v. Federal Commissioner for Taxation [1963] 109 CLR 9 ***(cons)***
Young v. Queensland Trustee Ltd [1956] 99 CLR 560 ***(cons)***
Federal Commissioner of Taxation v. Cook [1980] 42 FLR 403 ***(cit)***
Henderson v. Ferderal Commissioner of Taxation [1970] 119 CLR 612 ***(con)***
United States v. Stewart [1940] 311 US 60 ***(cons)***
Nowegijick v. The Queen [1983] 1 SCR 29 ***(dist)***
Bachrach v. Nelson [1932] 182 NE 909 ***(foll)***
Essondon Corp. v. Criterion Theatres Ltd. [1947] 74 CLR 1 ***(cit)***
Resch v. Federal Commissioner of Taxation [1938] 66 CLR 198 ***(cons)***

Legislation referred to:
Constitution of Australia [Aust], ss. 51(i), (ii), 90, 114
British North America Act 1867 [Canada], s. 125
Income Tax Assesment Act 1936 [Aust], Part IIIA, Part IX, ss. 6(1), 17, 25(1), 26, 160A-160ZZU
Income Tax Act 1974 [Canada], s. 125
Judiciary Act 1903 [Aust], s. 18
Public Finance and Audit Act 1987 [Aust], s. 21
Superannuation Act 1988 [Aust], s. 6

For the plaintiffs - B.M. Selway
For the defendants - Australian Government Solicitor
For the interveners - H.K. Roberts, (K.M. O'Shea with him)

JUDGMENT

Mason CJ, Deane, Toohey, Gaudron JJ:

The plaintiffs, the State of South Australia and the South Superannuation Fund Investment Trust (SASFIT), commenced an action in this Court seeking declarations:

(a) that SASFIT is "a State" for the purpose of s. 114 of the Constitution

(b) that the plaintiffs are not liable to pay income tax on income received into or on account of the South Australian Superannuation Fund (the Fund) or on net capital gains made by the Fund for the period from 1 July 1988 to 19 October 1989 by reason of s. 114 of the Constitution and s. 271 of the Income Tax Assessment Act 1936 (Cth) (the Act); and

(c) that the plaintiffs are not liable to pay income tax in respect of income received into or on account of the Fund and net capital gains made by the Fund after 19 October 1989.

By their defence the defendants, the Commonwealth of Australia and the Commissioner of Taxation, assert that SASFIT is not the State of South Australia, that the fund is not property of the state and that the relevant laws, the Taxation Laws Amendment Act (No. 2) 1989 (Cth) and the Taxation Laws Amendment (Superannuation) Act 1989 (Cth), do not operate so as to impose a tax on property of any kind belonging to the State of South Australia.

Pursuant to s. 18 of the Judiciary Act 1903 (Cth) Mason CJ stated a case for the consideration of the Full Court. The case reserved the following questions for the opinion of the Full Court:

1. (a) Prior to 19 October 1989 was SASFIT; and

   (b) is SASFIT now

   the State of South Australia within the meaning of s. 114 of the Constitution?

2. (a) Prior to 19 October 1989 was property held on account of the fund; and

   (b) is property now held on account of the fund property of any kind belonging to a state" within the meaning of s. 114 of the Constitution?

3. Is SASFIT exempt from paying income tax on income received into or on account of the fund or net capital gains made by the fund for for the period 1 July 1988 to 19 October 1989 by reason of s. 114 of the Constitution and s. 271 of the Act?

4. Is SASFIT exempt from paying income tax on income received into or on account of the fund or net capital gains made by the fund after 19 October 1989 by reason of s. 114 of the constitution and s. 271 of the Act?

At the hearing of the stated case the defendants did not offer argument on question 1 and 2, accepting that SASFIT is relevantly the State of South Australia and that the assets of the Fund are property of the state for the purpose of s. 114 of the Constitution. As the answer to the stated case no longer depends on whether SASFIT was the State of South Australia within the meaning of s. 114 of the Constitution both prior to and after 19 October 1989, it is unnecessary to explore the difference between the Superannuation Act 1988 (S.A.) and that Act as amended in 1989, which were thought to be material to the issues raised by questions 1 and 2. As the differences are no longer material, questions 3 and 4 will attract the same answer. Furthermore, the parties have agreed that it will be sufficient if the answer to questions 3 and 4 in the stated case are confined to income derived by way of interest on money lent and capital gains made by the fund. It follows that we need refer only to the facts recited in the stated case which are relevant to those answers.

SASFIT was continued in existence and was incorporated by s. 6 of the Superannuation Act 1988. That act came into operation on 1 July 1988 and repealed the Superannuation Act 1974 (S.A.). The Superannuation Act 1988 makes provision for the payment of superannuation benefits to South Australian statutory officers and public sector employees. The statutory scheme established the fund into which contributor's contributions are paid either directly or indirectly.

At all material times the assets of the Fund comprised:

(a) the interest held by SASFIT on account of the fund in investments such as government securities, loans secured by government guarantee, company debentures and notes;

(b) the interest in land and buildings held by SASFIT on account of the fund;

(c) the interest held by SASFIT on account of the fund in shares listed on a stock exchange;

(d) the interest held by the SASFIT on account of the fund in convertible notes in companies listed on a stock exchange;

(e) the interest held by SASFIT on account of the fund in loans to and shares in unlisted companies and units and interests in trusts;

(f) money invested by SASFIT on the short-term money market;

(g) rights and interests in respect of assets such as share options held by SASFIT on account of the fund; and

(h) any amount standing to the credit of the account kept pursuant to s. 21 of the Public Finance and Audit Act 1987 (S.A.)

Income derived by the Fund on its assets includes interest earned on money loaned by SASFIT in respect of the Fund in the manner set out in the preceding paragraph. Rather than deal individually with the various kinds of income derived by SASFIT from the above investments, it was agreed in the course of argument that the appropriate course is for the Court to confine itself at this stage to a consideration of the position in relation to income consisting of such interest.

From time to time there are paid into the Fund receipts which include "capital gains", in the sense in which that phrase is used in the Act, in respect of assets of the Fund. The capital gains are derived from the sale of interests in real and personal property of SASFIT in respect of the Fund, including shares, securities, units held in unit trusts and interests held in trusts, joint ventures, leases and other arrangements.

Pursuant to Pt. IX of the Act, comprising ss. 267-315, which was inserted in 1989 by the Taxation Laws Amendment Act (No. 2) and amended by the Taxation Laws Amendment (Superannuation) Act, liability for taxes was imposed upon certain income, receipts and net capital gains by superannuation funds, with effect from 1 July 1988. The Commissioner of Taxation claims that the fund is a superannuation fund to which Pt. IX applies and that SASFIT is therefore liable to pay tax on the taxable income of the Fund. The plaintiffs claim that, by virtue of s. 114 of the Constitution and s. 271 of the Act, the Commonwealth has no power to impose such a tax upon SASFIT and the Commissioner of Taxation has no power to assess the amounts as being taxable.

It is common ground that, but for s. 114 and s. 271, SASFIT is liable to lodge a return of income and is liable to pay tax on the taxable income of the Fund. SASFIT accepts that it is a "complying superannuation fund" as that expression is defined by s. 267 (s. 278) of the Act. The trustee of a complying superannuation fund is liable to pay tax on the taxable income of the Fund of the year of income (s. 278). A complying superannuation fund is an "eligible superannuation fund" as defined by s. 267 (s. 278) and is therefore an "eligible entity" as defined by that sub-section. The taxable income of an eligible entity shall be calculated as if the trustee were a taxpayer and a resident (s. 272). A reference in Pt. IX to a fund includes a reference to a fund established by:

(a) a law of a state or

(b) a public authority constituted by or under a law of a state (s. 270).

The provisions of Pt. IX were drafted with an eye to the possibility that the provisions of the Part might infringe the prohibition in s. 114 of the Constitution by imposing a tax on property of a state. Section 271 deals with that situation. Subsection (1) provides:

> It is the intention of the Parliament that if, but for this section, this part would have the effect that a law imposing taxation would impose tax on property of any kind belonging to a State within the meaning of s. 114 of the Constitution, this part shall not have that effect.

Section 114 of the Constitution:

The immunity from the imposition of taxation which is conferred by s. 114 on the Commonwealth and the States, though confined to taxes on property, is expressed in wide terms. The immunity extends to "**any** tax on property of **any** kind" (emphasis added) belonging

to the Commonwealth or to a state, as the case may be. The immunity thereby conferred might appear, on its face, to travel beyond a freedom from those forms or classes of taxation described as a "tax on property" or a "property tax" and to exempt the property of the Commonwealth or a state from any form of tax. No doubt there are policy reasons which would support that broad interpretation of s. 114. Such a broad interpretation would protect the operations of each government within the federal framework and in this way contribute to harmonious intergovernmental relationships. The Supreme Court of Canada has given just such an interpretation to the rather similar provisions of s. 125 of the British North America Act 1867 (See the majority judgment in *Re Exported Natural Gas Tax* [1982] 1 SCR 1004, at p. 1078; [1982] 136 DLR (3d) 385, at p. 444:

> The purpose of this immunity ... is to prevent one level of government from appropriating to its own use the property of the other or the fruits of that property. This immunity would be illusory if it applied only to taxes 'on property' but not to a tax on the Crown in respect of a transaction affecting its property or on the transaction itself.

But cf. the dissenting judgment of Laskin CJ, McIntyre and Lamer JJ at pp. 1035-1040; pp. 411-414 of DLR, where the Australian authorities were relied upon in support of a strict interpretation.)

However, in the course of judicial decisions beginning in 1904, this Court has not adopted that broad reading of the section. Instead, the Court has treated the section as conferring an immunity from a tax on property in its strict sense, that is, from "taxation imposed upon property *qua* property" (*D'Emden v. Pedder* [1904] 1 CLR 91, per Griffith CJ at p. 108; *Attorney General of N.S.W. v. Collector of Customs for N.S.W. (the Steel Rails Case)* [1908] 5 CLR 818, per Higgins J at p. 854; see also *The Municipal Council of Sydney v. The Commonwealth* [1904] 1 CLR 208, per Griffith CJ at pp. 231-232; but cf. *Queensland v. The Commonwealth* (*The First Fringe Benefits Tax Case)* [1987] CLR 74, per Gibbs CJ at p. 92), that is to say, a tax imposed upon property "as such" (See, for example, the *Steel Rails Case* [1908] 5 CLR, at p. 854; and, for a recent acceptance of this construction of the phrase in s. 114, *The First Fringe Benefits Tax Case* [1987] 162 CLR, per Mason, Brennan and Deane JJ at pp. 97-98; Dawson J at p. 105).

True it is that King CJ in *Superannuation Fund Investment Trust v. Commissioner of Stamps* [1980] 25 SASR 35, at p. 38, and Gibbs CJ in his dissenting judgment in *The First Fringe Benefits Tax Case* [1987] 162 CLR, at p. 88, expressed difficulty in understanding what was meant by the expression "tax on property *qua* property". While the boundaries of the area covered by such a tax are likely to be blurred and there may be room for difference of opinion about whether a tax which falls within the borderline area can properly be characterised as a tax upon property *qua* property, it seems to us that the phrase does effectively and correctly convey the central notion to which regard must be paid in determining whether a particular tax is a "tax upon property" for the purposes of s. 114.

It has often been pointed out that the description "tax on property" is elliptical in that property does not pay taxes; individuals do (See, for example, *Bennett & White (Calgary) Ltd. v. Municipal District of Sugar City No. 5* [1951] AC 786, at p. 817; *Re Exported Natural Gas Tax* [1982] 1 SCR, at p. 1079; [1982] 136 DLR (3d), at p. 444; *The First Fringe Benefits Tax Case* [1987] 162 CLR, at p. 104). The word "property" carries with it connotations of ownership or possession and the notion which expressions such as a tax on property *qua* property " or "as such" are intended to convey is that of a tax to which a person is subjected by reason of his or her ownership or holding of property.

Recognizing this, O'Connor J in the *Steel Rails Case* [1908] 5 CLR said, at p. 844, that the section conferred an immunity from a tax on property in its strict sense, that is, from "an exaction made in respect of the holding or ownership of property". This formulation was accepted and applied by Mason, Brennan and Deane JJ in *The First Fringe Benefits Tax Case* [1987] 162 CLR, at pp. 97-98; see also per Dawson J at p. 108. So understood, the section protects a state from taxation imposed on it by virtue of or by reason of its ownership or holding of property.

Accordingly, a tax is properly characterised, for the purposes of s. 114, as a "tax on property" if, and only if, it is imposed upon a taxpayer by reference to a relationship between the taxpayer and the relevant property and the relationship is such that the tax represents a tax on the ownership or holding of the property in question (See, generally, *The First Fringe Benefits Tax Case, ibid.,* at pp. 98, 104-105*).* That was, in effect, the point being made by Higgins J in the *Steel Rails Case* when he pointed to the "fundamental difference between taxing men for having property, and taxing men for moving property" (See, [1908] 5 CLR, at p. 854, quoted by Laskin CJ, McIntyre and Lamer JJ. In *Re Exported Natural Gas Tax* [1982] 1 SCR, at p. 1040; [1982] 136 DLR (3d), at p. 414; and by Mason, Brennan and Deane JJ in *The First Fringe Benefits Tax Case* [1987] 162 CLR, at p. 97).

The need to interpret the section in the context of other provisions of the Constitution, particularly the legislative powers possessed by the Parliament under s. 51(i) and (ii), as well as s. 90, played a large part in the adoption of the strict view of the immunity conferred by the section (See, generally, the judgment in the *Steel Rails Case*). That interpretation does not restrict legislative freedom of choice as severely as would the broad interpretation. The strict interpretation "gives a powerful measure of protection to the financial integrity of a state without preventing the Commonwealth from taxing every form of transaction to which a state is a party" (*The First Fringe Benefits Tax Case* [1987] 162 CLR, per Mason, Brennan and Deane JJ at p. 98). Further the adoption of a broad view of the immunity might lead to anomalies in the case of government-owned corporations formed with a view to their competing on favourable terms with private enterprise. One illustration, germane to the present case, will suffice. Were the immunity to extend to a tax on income, as the immunity conferred by words similar to s. 114 in s. 87 (b) of the Indian Act 1970 (Can.) has been held to extend (*Nowegijick v. The Queen* [1983] 1 SCR 29; [1983] 144 DLR (3d) 193), the Commonwealth Parliament would be denied power to subject a corporation owned by a state to a liability to pay income tax even if the corporation is engaged in commercial competition with private enterprise.

In the evolution of the interpretation of s. 114 it came to be recognised that a distinction should be drawn between a tax on property and a tax on transactions, a distinction which was applied in the *Steel Rails Case* itself, where customs duty levied on the importation by a state of steel rails was held to be a customs duty on the movement of goods rather than a tax on property. Although the distinction between a tax on property and a tax on transactions has continued to be a very important factor in the interpretation and application of the section, it has been acknowledged that a tax framed as a tax on transactions may nevertheless in some circumstances amount to a tax on property, that is , a tax on the ownership or holding of property (*The First Fringe Benefits Tax Case* [1987] 162 CLR, per Mason, Brennan and Deane JJ at p. 98). That is because the prohibition contained in s. 114 is a matter of substance rather than a form and because a tax imposed by reference to the ownership or holding of property may take the form of a tax on transactions. So, in *The First Fringe Benefits Tax Case,* the Court held that a tax on the use of property by an owner was a tax on the ownership or holding of property.

In that case, Mason, Brennan and Deane JJ expressed an *obiter dicta* view that "a tax on the possession or use of property would constitute a tax on the ownership of that property" (*ibid*., at p. 98). The reference to "use" in that statement should not have been left unqualified. A tax on the use of property will fall close to the border of what does and does not relevantly constitute a "tax on property" and, as we have pointed out, that boder is likely to be blurred. It will, to adopt the phraseology of Dawson J in *The First Fringe Benefits Tax Case* (*ibid*., at p. 105), "constitute... a tax on property" if it is, upon analysis, "tantamount to a tax upon the holding or ownership of (the) property". Thus, for example, a tax on riding a bicycle or driving a motor vehicle on a public road may be described as a tax on the use of property. However, such a tax would not, without more, properly be characterized as a "tax on property" for the purposes of s. 114. On the other hand, a tax imposed upon the use or occupation of land by the owner would be a "tax on property" for the purposes of s. 114 for the reason that it is tantamount to a tax upon the ownership or holding of the relevant land. *The Municipal Council of Sydney v. The Commonwealth* [1904] 1 CLR, per Griffith CJ at pp. 232-232; see also *Essendon Corporation v. Criterion Theatres Ltd.* [1947] 74 CLR 1, per Latham CJ at p. 13).

Is a tax on income a tax on property?

The plaintiffs' contention that a tax on income is a tax on property is not without some force. The contention is expressed in two ways: first, that the tax is imposed on items of revenue or income which themselves constitute property so that a tax on income is, without more, a direct tax on property; and, secondly, that a tax on income in the form of interest is in substance a tax on the property (the capital) which produces the income. This second way of putting the argument represented the main thrust of the plaintiffs' case. The need to establish, in conformity with the authorities culminating in *The First Fringe Benefit Tax case*, that the tax is a tax on the ownership or holding of property by the state made it virtually inevitable that the argument would be presented in this way. In essence, the plaintiffs' argument is that income tax is a tax on the taxpayer's ownership of property because it taxes the fruits of that property.

At first glance, authority in both the United States and Canada appears to provide some support for the first way in which the plaintiffs' put the argument. Thus, in *Nowegijick,* the Supreme Court of Canada held that a tax on income is in reality a tax on property itself, on the footing that money or any other thing of value acquired as gain or profit from capital or labour is property, [1983] 1 SCR, per Dickson J at p. 38 [1983] 144 DLR (3d) at pp. 199-200. In reaching this conclusion, the Supreme Court of Canada followed the approach that had been adopted in the United States (See *Bachrach v. Nelson* [1932] 182 NE 909, at p. 914).

However, the question at issue in *Nowegijick* did not concern s. 125 of the *British North America Act;* the question was whether the tax imposed by the Income Tax Act 1970 (Can.) imposed a tax "in respect of ... any" of the "personal property" of an Indian within the meaning of s. 87 (b) of the Indian Act. The Income Tax Act imposed tax on the taxable income of a taxpayer, the expression "taxable income" being defined by s. 2(2) as the income of a taxpayer less permitted deductions. The liability was imposed at the point of receipt of the salary. The taxpayer argued that a person's "taxable income" is not "personal property" and is no more than a "concept" that results from a number of operations. The Court rejected that argument on the ground that it was "too fine a distinction" [1983] 1 SCR, per Dickson J at p. 38; [1983] 144 DLR (3d), at p. 200. In the result, the Court held that income tax levied on wages was a tax in respect of personal property of the taxpayer, the relevant income in the form of wages being the property subject to tax. However, *Nowegijick* did not address, even

less decide, the question whether income tax is a tax on the ownership or holding of property in the sense in which s. 114 has been interpreted and that is the critical question to be decided.

In Australia, under the Act, income tax is imposed "upon the taxable income derived during the year of income" by the taxpayer (s. 17). For present purposes, the "taxable income" of a taxpayer is defined to mean "the amount remaining after deducting from the assessable income all allowable deductions" (s. 6(1)). The assessable income of a taxpayer who is a resident includes "the gross income derived directly or indirectly from all sources whether in or out of Australia" which is not exempt income (s. 25(1)). Dixon J said that the Income Tax Assessment Act 1922 (Cth) did not maintain "the distinction between profits of a capital nature and profits in the nature of income in the strict sense" (*Resch v. Federal Commissioner of Taxation* [1942] 66 CLR 198, at p. 225). The same comment may be made about the present Act. Section 26 and succeeding provisions of the Act make provisions for the inclusion in the assessable income of the taxpayer of receipt which would not otherwise have the character of income. "Income" is a generic term which, in the United States, has been regarded as wide enough to include capital gains for purposes of income tax (*Merchants' Loan & Trust Co. v. Smietanka* [1921] 25 U.S. 509; *United States v. Stewart* [1940] 311 U.S. 60, per Douglas J at p. 63). Nonetheless , it is correct to say of the Act, as Starke J said of the Income Tax Assessment Act 1922, that income tax "is not a tax upon everything that comes in whether an income receipt or a capital receipt" (*New Zealand Flax Investment Ltd. v. Federal Commissioner of Taxation* [1938] 61 CLR 179, at p. 197).

The fact that income is a generic term and the fact that both the assessable and the taxable income of a taxpayer are concepts, not descriptions of property which belongs to the taxpayer, support the view that income tax is not a tax on the ownership or holding of property as contemplated by s. 114. Moreover, the Act focuses its attention upon the **derivation of income** by the taxpayer, not upon the ownership or holding of property. The notion of derivation of income is a complex one involving, as it does, considerations divorced from the ownership and holding of property. As Dixon J observed in *Commissioner of Taxes (S.A.) v. Executor Trustee and Agency Co. of South Australia Ltd. (Carden's Case)* [1938] 63 CLR 108, at p. 152.

> Income profits and gains are conceptions of the world of affairs and particularly of business ... (I)n nearly every department of enterprise and employment the course of affairs and the practice of business have developed methods of estimating or computing in terms of money the result over an interval of time produced by the operations of business, by the work of the individual, or by the use of capital. The practice of these three methods of computation and the general recognition of the principles upon which they proceed are responsible in a great measure for the conceptions of income, profit and gain and therefore, may be said to enter into the determination or definition of the subject which the legislature has undertaken to tax.

In conformity with this view of income, the Courts have placed reliance upon the conceptions of business and principles and practices of commercial accountancy in order to arrive at an assessment of income, the object being "to discover what gains have during the period of account come home to the taxpayer in a realized or immediately realizable form" (*ibid.*, per Dixon J at p. 155).

In particular, the Courts look to these conceptions, principles and practices in deciding whether income has been "derived" by a taxpayer. "Derived" is the equivalent of "arising" or "accruing" (*ibid.*, per Dixon J at p. 157; see *Harding v. Federal Commissioner of Taxation* [1917] 23 CLR 119, per Isaacs J at p. 133), but it does not necessarily mean "actually received",

though "ordinarily that is the mode of derivation" (*Federal Commissioner of Taxation v. Thorogood* [1927] 40 CLR 454, per Isaacs ACJ at p. 458). The ultimate inquiry is to ascertain whether what has taken place, whether it be the earning or the receipt of a sum of money or other benefit or advantage, is "enough by itself to satisfy the general understanding among practical business people of what constitutes a derivation of income", to repeat the comment of Barwick CJ, Kitto and Taylor JJ in *Arthur Murray (N.S.W.) Pty. Ltd. v. Federal Commissioner of Taxation* [1965] 114 CLR 314, at p. 318.

Viewed in the light of these general considerations, the income tax (excluding capital gains tax) imposed by the Act on income produced by property belonging to the taxpayer cannot be characterized generally as a tax on the ownership or holding of that property. Income tax generally cannot be characterized as a tax of that kind. However, it is conceivable that the particular relationship between a type of income and the property which produces it might be such that the income tax imposed by the Act on taxable income calculated by reference to that type of income is, for relevant purposes, a tax on the property. Accordingly, it is desirable to examine rather more closely the impact of the tax on interest payments forming part of the assessable income of a taxpayer.

The Relationship between Income Tax and Interest on Money Lent

Interest on money lent is in substance a payment received for the use by a borrower of the lender's money. Though interest is income or profit derived from the principal sum lent to the borrower, it is a debt separate from the principal sum and may be recovered as such, as the common indebitatus count for interest shows (*Norman v. Federal Commissioner for Taxation* [1963] 109 CLR 9, per Windeyer J at p. 38; and see, generally, *Young v. Queensland Trustee Ltd.* [1956] 99 CLR 560). The chose in action for interest comes into existence upon the making of the loan and is thereafter a presently existing chose in action, even though the interest is not due and payable until some future date [1963] 109 CLR, at p. 37. However, the vesting of the chose in action is not the occasion for the imposition of the tax. It is the **derivation** of the interest by the taxpayer which results in its inclusion in the assessable income and, where appropriate, in the taxable income. The time of derivation is not the same as and, in many cases, will not coincide with the time of vesting of the chose in action. In the case of income by way of interest, the income is derived when the interest payment is received or, if the taxpayer's taxation accounts are complied on an accruals basis, when the interest payment accrues, that is, when the amount of the interest becomes due and payable.

In the ultimate analysis the tax is imposed not upon the ownership or holding of property belonging to the taxpayer but upon gains of a revenue kind in the form of interest on money lent derived by the taxpayer in the relevant period, the derivation being ascertained by reference to the conceptions, principles and practices already mentioned. Granted that the taxpayer comes under a liability because he or she derives income which can be identified with a chose in action of which he or she is the owner or holder, nevertheless the true character of the tax is, as its name implies, that of income tax rather than a tax on the ownership or holding of property. The derivation of income by a taxpayer is a subject relevantly different from the ownership or holding of property.

Capital Gains

The effective exemption of superannuation funds from liability to pay capital gains tax ended as from 1 July 1988, coinciding with the ending of the exemption of superannuation funds from liability to pay income tax. Thereafter superannuation funds became liable to capital gains tax under Pt. IIIA of the Act (ss. 160 A-160 ZZU). Where a net capital gain accrued to a taxpayer in respect of the year of income, the assessable income of the taxpayer of the

year of income, includes that net capital gain (s. 160Z0 (1)). Generally, where an asset acquired after 20 September 1985, other than a personal use asset, has been disposed of or is deemed to have been disposed of during the year of income and where the consideration in respect of the disposal exceeds the indexed cost base to the taxpayer in respect of the asset, a capital gain equal to the exceeds shall be deemed to have accrued to the taxpayer during the year of income (s. 160 Z(1)(a)). Special provision is made with respect to the disposition has non-listed personal use assets (s. 160 Z(2)), but that provision has no relevance to the present case. Likewise, the provisions with respect to the disposal of assets used solely by a taxpayer for the purpose of producing exempt income and the disposal of personal use assets are not presently relevant. In what is written below, attention is directed to the central provisions of the Act and some qualifications and special provisions have been ignored as irrelevant for present purposes.

The cost base of an asset to a taxpayer by s. 160 ZH(1) so as to include the cost of acquisition, incidental costs of acquisition and disposal, and certain expenditure of a capital nature on the asset. The indexed cost base of an asset to a taxpayer is defined by s. 160 ZH(2) so as to refer to the items of cost identified in s. 160 ZH(1) on the footing that the items of cost are indexed in accordance with the provisions of s. 160 ZJ. That section provides for indexation according to the index numbers, published quarterly by the Australian Statistician, in the period elapsing between the incurring of the relevant costs and the date of disposal of the asset by the taxpayer. Provision is also made for the ascertainment of a reduced cost base of an asset to a taxpayer (ss. 160ZH (3) and 160ZK), but the circumstances in which such a reduced cost base applies are not material to the question now under consideration.

What emerges from the outline set out above is that capital gains tax is imposed on the disposal or demand disposal of an asset owned by a taxpayer , the tax being effectively imposed upon the net capital gain which accrues to the taxpayer, By reason of the provisions relating to the ascertainment of the indexed cost base of the asset to the taxpayer, the amount of the net capital gain will depend upon the length of time for which the taxpayer has held the asset because it is generally necessary to take into account the index numbers published quarterly in that period in computing the indexed cost base.

True it is that the capital gains tax is not levied on the proceeds of sale of an asset. But the net capital gains which represent part of the proceeds of sale fall into assessable income. And the reason for the imposition of the tax is the exercise by the taxpayer of the right of disposition, a right central to the concept of ownership of property. Furthermore, the capital gains tax imposed by the Act generally has the additional element already mentioned, namely, that the amount of the capital gain is computed by reference to the length of time during which the taxpayer has been the owner of the asset. Viewed in this light, the tax is a tax on the ownership or holding of property belonging to the taxpayer.

In the result we would answer the questions asked in the stated case as follows:

1. (a) Not necessary to answer.
   (b) Not necessary to answer.
2. (a) Not necessary to answer.
   (b) Not necessary to answer.
3. As to income tax on interest derived from money lent - No. As to income tax on net capital gains - Yes.

4. As to income tax in interest derived from money lent - No. As to income tax on net capital gains - Yes.

Brennan and McHugh JJ:

For the reasons stated by the majority of the Court, we agree that the tax imposed on net capital gains by operation of s. 160 Z0 of the *Income Tax Assessment Act* 1936 (Cth) (the Act) falls within the description of a tax on property in s. 114 of the Constitution. Although we would also respectfully agree that tax on interest on money lent by a taxpayer is not a tax on the capital, we have formed a view different from their Honours' view as to the character of the tax on income which falls within s. 25(1) of the Act as income according to the ordinary conceptions and usages of mankind, including the interest payable on a loan.

The case was argued on the footing that, unless the tax imposed on income derived by the South Australian Superannuation Fund Investment Trust (SASFIT) were characterized as a tax on property, SASFIT would be liable to pay tax upon the taxable income of the South Australian Superannuation Fund as though SASFIT were a resident taxpayer (ss. 268, 272, 278). It is necessary to decide this case upon that assumption. Accordingly, in determining whether SASFIT is immune from tax assessed under the Act by reference to interest on money lent by SASFIT, the question is whether a tax imposed on a resident taxpayer's taxable income, being the surplus of assessable income (according to ordinary concepts) over allowable deductions, is a tax on property.

For the reasons stated by the majority, the immunity from taxation conferred on the states by s. 114 of the Constitution is usually said to be limited to "an exaction made in respect of the holding or ownership of property" (See *Attorney - General* of *N.S.W. v. Collector of Customs for N.S.W.* (the *Steel Rails Case*) [1908] 5 CLR 818, at p. 844. To describe a tax on property as a tax on the holding or ownership of property is a helpful guide in distinguishing a tax on property from a tax on transaction, although the dichotomy is not complete. As *Deputy Commissioner of Taxation v. State Bank of New South Wales* (Unreported, published concurrently with this judgment on 25 February 1992) illustrates, a tax on transaction may sometimes operate in substance as a tax on property. The description of a tax falling withn s. 114 of the Constitution as a tax on the holding or ownership of property is not intended to exclude from the scope of the immunity a tax on property which is received, held or owned on revenue account rather than on capital account. Property which is received on revenue account by a state is property belonging to the state, and if a tax be imposed upon the receipt of that property, it is a tax on the ownership of the property received. There is no relevant distinction to be drawn between a tax on receipt of an item on capital account (as in the case of capital gains) and a tax on receipt of an item on income account. The immunity created by s. 114 is from tax on any property which belongs to Commonwealth or state (as the case may be). The immunity is not restricted to taxes on property from or out of which other property of the Commonwealth or a state is derived. A tax which taxes fruit may not tax the tree, but if the fruit belongs to the Commonwealth or a state, s. 114 protects ownership of the fruit as well as ownership of the tree. A tax on either the fruit or the tree is offensive to s. 114.

The scope of the s. 114 immunity thus extends to taxation on property of any kind, whether the property be an item of revenue or an item of capital. Indeed, if s. 114 were not to protect the revenue of a state from taxation by the Commonwealth and the revenue of the Commonwealth from taxation by a state, the taxing power of either polity could be undermined by an exercise of the taxing power of the other. The immunity would be illusory if tax revenue

could be depleted by adverse taxation. And s. 114 would have an illogical operation if it failed to protect the revenue of a state or the revenue of the Commonwealth from taxation by the other but protected capital held or owned by a state or by the Commonwealth.

To attribute a character to a tax imposed by the Act in reference to items constituting income according to ordinary concepts, it is necessary to identify what it is that attracts the liability to tax. Section 17 of the Act brings to charge taxable income derived during a year of income. Taxable income is defined (s. 6(1)) relevantly to mean "the amount remaining after deducting from the assessable income all allowable deductions". By s. 25(1), a resident taxpayer's assessable income includes the gross income derived directly or indirectly from all sources by the taxpayer, subject to certain immaterial exceptions. Although "taxable income" is defined as an "amount", and is therefore defined as a pecuniary figure rather than as property, the "amount" is the remainder ascertained by deducting all allowable deductions from the assessable income of a taxpayer. The year in which taxable income is derived is therefore the year in which the relevant assessable income is derived, and the tax levied by s. 17 on taxable income is a tax which is imposed on the relevant assessable income although it is tax which is imposed on the relevant assessable income although it is calculated upon a net amount after deducting allowable deductions. It is not a tax on the act or transaction of derivation of assessable income; the derivation of assessable income attracts no liability to tax.

Assessable income which is income according to ordinary concepts is property, though its amount be expressed as a pecuniary figure: it is money's worth (*Federal Commissioner of Taxation v. Cooke* [1980] 42 FLR 403, at p. 413; 29 ALR 202, at p. 211). Money received by a taxpayer during an income year is income derived by the taxpayer if it has been earned or it becomes income derived by the taxpayer when it is earned (*Arthur Murray (N.S.W.) Pty. Ltd. v. Federal Commissioner of Taxation* [1965] 114 CLR 314). Income may also be derived during a year of income though it is not received during that year provided it is a debt owing to the taxpayer (*Henderson v. Federal Commissioner of Taxation* [1970] 119 CLR 612, at p. 650-651), albeit not a debt due for payment during the income year (*J. Rowe & Son Pty. Ltd. v. Federal Commissioner of Taxation* [1971] 124 CLR 421, at p. 450). In short, assessable income, being income according to ordinary concepts, is not derived during a year of income unless the taxpayer has acquired property on revenue account during that year.

The tax levied by s. 17 is attracted by the surplus of the value of property answering the description of assessable income derived during an income year over the amount of the allowable deductions for that income year. The tax is not imposed on the act or transaction of derivation but on property which the taxpayer has acquired on revenue account. In one sense, the tax may be said to be a tax on the ownership of the property acquired but, as we are not here concerned to distinguish a tax on property from a tax on transaction, we would prefer to say simply that income tax on income according to ordinary concepts derived by a taxpayer during a year of income (including interest derived from the lending of money) is a tax upon that income and that such a tax on property (cf. the approach taken by the Supreme Court of Canada in *Nowegijick v. The Queen* [1983] 1 SCR 29, at p. 38-39; [1983] 144 DLR (3d) 193, at p. 200, where the statutory context was somewhat different).

We would therefore answer questions 3 and 4 of the questions reserved as follows:

> As to income tax on interest derived from money lent and as to income tax on net capital gains - Yes.

In accordance with the parties' agreement, there should be no order as to costs.

Dawson J:

I agree with the reasons for judgment of Mason CJ, Deane, Toohey and Gaudron JJ with the answers which they propose I desire only to add the following observations:

Section 114 of the Constitution precludes the Commonwealth from imposing any tax on property of any kind belonging to a state. There is a reciprocal prohibition against a state imposing any tax on property of any kind belonging to the Commonwealth. The phrase "tax on property" cannot be interpreted literally. A tax on property is a tax upon a taxpayer in relation to property. It is the relationship between the tax and the property which will, if it is sufficiently direct and substantial, characterize the tax as a tax on property. In *Queensland v. The Commonwealth (The First Fringe Benefits Tax Case)* [1987] 162 CLR 74, at p. 98, Mason, Brennan and Deane JJ held that a tax upon the holding or ownership of property is a tax on property and that some taxes upon the use of property may also amount to a tax on the property itself. I also agreed (*ibid*., at p. 104) that a tax upon the holding or ownership of property is a tax on property. Further, I expressed the view (*ibid*., at p. 105) that otherwise a tax will only be of that character if it is tantamount to a tax upon the holding or ownership of property; the example I gave was a tax upon the proceeds of sale of property.

The view which I expressed gave a somewhat narrower scope to the concept of a tax on property than has been given to the like concept in s. 125 of the Canadian Constitution, but I adhere to that view. However one approaches the problem, it is a question of distinguishing between a tax on property and a tax which is not upon the property itself but merely upon a transaction affecting the property. The expression a tax "upon property *qua* property" was used by the Court in *D'Emden v. Pedder* [1904] 1 CLR 91, at p. 108, to describe the kind of tax that falls within the prohibition contained in s. 114 of our Constitution. Difficulties have been expressed about the use of that expression (See *The First Fringe Benefits Tax Case* [1987] 162 CLR, per Gibbs CJ at p. 88, *Superannuation Fund Investment Trust v. Commissioner of Stamps* [1980] 25 SASR 35, per King CJ at p. 38), but it seems to me to be an apt enough means of distinguishing between a tax which is a tax upon the holding or ownership of property or its equivalent and a tax upon a transaction affecting the property.

The distinction was, perhaps, made clearer in *Attorney - General of N.S.W. v. Collector of Customs for N.S.W.* (the *Steel Rails Case*) [1908] 5 CLR 818, where a majority appear to have held that the customs duties were not a tax on property (that is goods) because they were a tax upon the act of importation rather than a tax on the goods themselves. Isaacs J, on the other hand, took the view that the customs duties were a tax on goods and were, therefore, a tax on property and it is by contrasting his judgment with those of the majority that the real distinction is to be seen. No doubt customs duties and, for that matter, excise duties, may be said to be taxes on goods because the incidence of the tax is determined by some step taken in relation to goods. But because the taxes are levied upon a step taken in relation to the goods - A transaction - And not upon the goods themselves, as in the case of a tax upon the simple holding or ownership of the goods, they are not a tax upon property *qua* property. The phrase "tax on goods" is elliptical, as is the phrase "tax on property", but the distinction between a tax on property as such and a tax upon a transaction involving property is a real one. It has consistently been held in this country, the most recent decision being *The First Fringe Benefits Tax Case*, that a tax which is not, or does not amount to, a tax upon the holding or ownership of property is not a tax upon the property itself. Thus it is that a tax on property is distinguished from a transaction tax.

Under the Income Tax Assessment Act 1936 (Cth) income tax is levied upon the taxable income derived by the taxpayer during the year of income: s. 17. Taxable income is relevantly defined to mean the amount remaining after deducting from the assessable income all allowable deductions: s. 6(1). The assessable income of a taxpayer who is a resident includes the gross income derived directly or indirectly from all sources whether in or out of Australia which is not exempt income: s. 25(1). Taxable income is therefore a net amount expressed in terms of money which can only be calculated by reference to a period of time (namely, a year of income). That is to say , it can only be calculated at the end of a period, when all allowable deductions are known, and for that reason it is not possible to identify particular sums of money as representing the taxable income of the taxpayer at any point during the period. Whilst property in the form of money may flow in and out of the taxpayer's hand during the period, no particular sum can be said to constitute property in the form of taxable income. Nor is it possible to say that income tax is a tax upon property in the form of assessable income to the extent that it represents taxable income. True it is that taxable income represents a proportion of the money or money's worth in the form of assessable income derived by the taxpayer during the year of income, but the proportion cannot be known until the end of the year when allowable deductions have been taken into account. Moreover, at the time when the taxable income of the taxpayer is calculated, that is, at the end of the year of income, the money or money's worth may have ceased to be the taxpayer's property. It would be artificial in those circumstances to speak of income tax as a tax on property represented by money or money's worth. So, taxable income is a concept of the Income Tax Assessment Act, being an amount which is calculable only by the deduction of allowable amounts from the assessable income.

In *Nowegijick v. The Queen* [1983] 1 SCR 29; [1983] 144 DLR (3d) 193, the Supreme Court of Canada concluded that a section of the Indian Act 1970 (Can.), which provided that no Indian should be subject to taxation in respect of any of his personal property situated upon a reserve, exempted the wages of an Indian from taxation. Dickson J, who delivered the judgment of the Court, said (*ibid*., at pp. 38-39; p. 200 of DLR):

> Although the crown... recognizes that 'salaries' and 'wages' can be classified as 'personal property' it submits that the basis of taxation is a person's 'taxable' income and that such taxable income is not 'personal property' but rather a 'concept', that results from a number of operations. This is too fine a distinction for my liking. If wages are personal property it seems to me difficult to say that a person taxed 'in respect of' wages is not being taxed in respect of personal property. It is true that certain calculations are needed in order to determine the quantum of tax but I do not think this in any way invalidates the basic proposition.

However, in that case the Court was concerned not with a provision such as s. 114, but with a provision of a very different kind which, being included in a statute relating to Indians, was to be liberally construed in favour of the Indian if its meaning was doubtful (*ibid*., at p. 36; p. 198 of DLR). Moreover, the words "in respect of" were clearly of crucial importance (*ibid*., at p. 39; p. 200 of DLR). It is clear that a tax may be in respect of property but not upon property. The former notion does not require fine distinctions to be made but the latter does. Indeed, Dickson J was prepared to recognize that there may be a distinction between a tax upon property and a tax on persons in respect of property (*ibid*., at p. 41; p. 202 of DLR).

In summary, income tax is not levied upon the property in the form of money's worth which flows in and out during the year of income. It is levied upon the taxable income which is an amount calculated by reference to that flow upon the principles laid down by the Income Tax Assessment Act. It is the derivation of income to the extent of that amount, rather than

the holding or ownership of money or money's worth, which is taxed, so that income tax is a tax upon an activity involving property rather than a tax upon the property itself. Of course, the mechanisms used to impose income tax may be used to impose a tax which is not truly an income tax, of which the generally, income tax is, I think, of the character which I have described.

Also found at [1992] 2 CLJ 964